

Financing a Metrorail Station

At

Potomac Yard

Preliminary Analysis of Concept
(Version 1.1)

City of Alexandria
May 13, 2008

INTRODUCTION

The following paper analyzes the concept of financing a new Metrorail Station at Potomac Yard. As this is the first stage of the complex financial analysis, this paper does not represent a full, final work product. The process of updating this report will be iterative, as new and updated information and revised development plans and schedules become available.

BACKGROUND

- It is estimated by the Washington Metropolitan Area Transit Authority (WMATA) staff that the cost to construct a Metrorail Station in Potomac Yard is between \$125 million and \$150 million.
- This WMATA cost estimate, as well as debt service assumptions, are orders of magnitude estimates, which will need to be refined.
- These costs are in 2008 dollars and would need to be eventually adjusted to the years of construction.
- The highest WMATA estimate of \$150 million will be used for the purposes of this analysis.
- Financing the \$150 million costs over a 30-year amortization period at the City's AAA/Aaa rated general obligation tax-exempt borrowing rates would result (using today's rates) in a true interest cost (TIC) of 4.39% and result in annual average debt service of \$9.1 million annually (see Attachment II).
- If revenue bonds were issued instead of general obligation bonds, the TIC would increase depending on the bond's credit structure and rating. Other methods or structures of debt financing could also decrease debt service costs from the \$9.1 million.

- It is likely that it will take a number of funding sources to finance a Metrorail Station at Potomac Yard such as:
 - 1) Federal transportation funds¹
 - 2) State transportation funds²
 - 3) Developer contributions
 - 4) Tax increment financing revenues
 - 5) Special tax district revenues
 - 6) City General Fund supported capital funds
- Any federal, state or outside source of funding would reduce the amount of local bond issuance, as well as decrease debt service needs from the \$9.1 million.
- Private funding is an option to consider, but a revenue stream from tax and developer sources would be needed to repay any private investment. The private sector cost of money is likely to be greater than the public sector.
- The cost to operate a surface Metrorail station is about \$1 million per year. This cost would be shared by all participating jurisdictions, resulting in a small City share.
- There are a number of ways to structure the issuance of bonds including utilizing:
 - 1) City government bond issuance (general obligation bonds, revenue bonds, certificates of participation or lease-purchase funding)
 - 2) Alexandria Industrial Development Authority
 - 3) Potomac Yard Community Development Authority (would need to be established)

¹ Federal funding is not a probable source due to the regional priority of the Dulles rail corridor project.

² Dependent upon the General Assembly action to substantially increase transportation funding.

- 4) Other public authorities in Virginia with bond issuing capacity
- As is the case with the private funding option, a dedicated, stable and reliable revenue stream would be needed to repay any bonds issued.
 - There are pros and cons to utilizing a non-City government entity to issue bonds, with a review of these pros and cons to occur as part of any future analysis.
 - A key issue will be how to minimize the need for, or level of, a “full faith and credit” pledge while keeping the cost of borrowing low (i.e., interest rates on bonds issued increases as the credit pledge weakens).
 - Another key issue to address will be how to tailor the repayment of the bonds to mirror the likely development build out schedule of Potomac Yard (and hence future tax generation), as it is likely that the Metrorail station would be built early in the development process.
 - Potomac Yard Metrorail Station bonds issued by a non-City government entity, but backed by City real estate tax revenues, represent overlapping debt and would be counted in the City’s debt ratios by the bond rating agencies. While this is a key issue, the City’s current low level of debt (about \$330 million) compared to the \$46.2 billion value of the City’s tax base will help dilute the problem of overlapping debt.

CURRENT CITY TAX REVENUES

- Utilizing 2008 real estate tax assessments³, the City currently receives about \$0.6 million in real estate taxes from Land Bays “G” and “H.”
- Utilizing 2008 real estate tax assessments³, the City receives about \$1.3 million in real estate taxes from the Potomac Yard Retail Center. The City also earns about \$2.1 million in sales, business license, meals, admissions and other local taxes per year. Of this \$2.1 million, 67% is derived from the one percent local retail sales tax. This brings the current tax yield of the Potomac Yard Retail Center to \$3.4 million per year.
- Therefore, the total current City-received tax yield from the Potomac Yard Retail Center and Land Bays “G” and “H” is currently \$4.0 million per year.

FUTURE CITY TAX REVENUES

- At full build out, if the density transfer is approved, Land Bays “G” and “H” would total some 1.6 million square feet of office and retail units, as well as 878 residential units and 625 hotel rooms. When complete, the real estate assessed value would total approximately \$1.1 billion.
- At the current City real estate tax rate of 84.5 cents, this \$1.1 billion in future property value would generate \$9.6 million in real estate taxes annually.

³ Reflects adopted 2008 real estate tax rate of 84.5 cents per \$100 of valuation.

- In addition, the retail and 625 hotel rooms in Land Bays G and H would generate \$2.8 million per year in sales, meals⁴ and transient occupancy taxes. Hotel occupancy taxes would produce \$2.6 million of this \$2.8 million⁵.
- In total, the direct tax revenue impact at full build out of Land Bays G and H in 2008 dollars would be \$12.4 million in annual tax revenues generated for the City.
- The Potomac Yard Retail Center (PYRC) does not have a redevelopment proposal at this time, but is a prime property for redevelopment.
- When the PYRC was constructed, it was intended as a temporary interim use.
- If one hypothetically assumes the same level of density in a redeveloped PYRC as currently exists in Land Bay G and then allocates the uses, one might develop:

1 million sq ft office 750,000 sq ft retail 2,500 residential units TBD hotel rooms
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- It should be noted that the above PYRC development assumption is for purposes of determining potential revenue impact, and does not represent either a developer proposal, or a City proposal.
- At full build out of this hypothetical redevelopment scenario, the future property value of this hypothetical redevelopment is estimated at \$1.5 billion.

⁴ Reflects 2008 meals tax rate of 4%.

⁵ Reflects 2008 hotel occupancy tax of 6.5% plus \$1 per room night.

- At the current City real estate tax rate of 84.5 cents, this \$1.5 billion in value would generate \$12.8 million in real estate taxes annually.
- In addition, the retail space (using current PYRC average per square foot retail sales data) would generate \$2.4 million annually.
- In total, the direct tax revenue impact at full build out of the PYRC hypothetical scenario would be \$15.5 million per year. Adding hotels to the PYRC development scenario would increase this tax revenue yield.
- Combining the annual tax revenue yields of Land Bays G and H, as well as a redeveloped PYRC, could yield as much as \$27.9 million per year at full build out.
- If one subtracts from this \$27.9 million in potential future tax revenues, the \$0.6 million in current Land Bays G and H annual tax revenues, as well as the \$3.4 million in current PYRC annual tax revenues, the net tax yield at full build out in 2008 dollars would be \$23.9 million.
- While development at Potomac Yard will generate significant new revenues, there also will be additional City costs to serve this development. The costs include, but are not limited to, police services, parks maintenance, refuse collection, and public education for K-12 students. While the government and school system will bear additional incremental costs, the net fiscal impact to the City when subtracting these costs from the previously described tax revenue generation remains significantly positive.
- When the Potomac Yard CDD plan and the Patent and Trademark Office (PTO) complex were considered by the City for land use approvals, fiscal impact studies were conducted which clearly

show that the proposed development would provide the City with a significant fiscal net benefit. Since these studies were completed, the value of commercial and residential property has grown far faster than the cost of providing government services.

- The most recent study was undertaken in 1999 for the U.S. Patent and Trademark Office. That study showed that for every tax dollar earned:
 - Hotels return 93.5% of tax dollars generated.
 - Retail returns 87.1% of tax dollars generated.
 - Office property returns 83.0% of tax dollars generated.
 - Condominiums return 53.3% of tax dollars generated.
 - Townhouses return 36.8% of tax dollars generated.
 - Apartments return 27.0% of tax dollars generated.
- The reason that residential property provides a lower return is that residents use City services at a greater rate than office workers, shoppers and hotel guests. One of the biggest factors influencing the fiscal impact is the cost of public school education which is driven by the number of public school students generated by residential property.
- With substantially increased residential property values (2001 to 2006) since this 1999 study, and with the demographic shifts of who occupies new residential units being constructed in the City (i.e., fewer public school students), the net positive fiscal impact of residential property is probably greater now than in 1999.

- In order to have updated and current fiscal impact data, the City plans to undertake a new fiscal impact study in 2008.

FINANCING A METRORAIL STATION

- This \$23.9 million in net new revenues compares to an annual debt service of \$9.1 million annually on a \$150 million bond issuance to pay for the construction of the Metrorail station. Therefore, one can conclude that these development projects could generate sufficient revenues to not only pay for this debt service, but also to pay for future City services to these development areas, as well as to pay for the general costs that the City incurs operating the City government, as well as funding the Alexandria City School system.
- A tax increment financing (TIF) type bond could be a workable financing instrument to capture a portion of the new tax revenues generated by these developments.
- Under a TIF, bonds are issued to pay for a project, and then tax revenues generated by the project pay the debt service on the TIF bonds.
- TIF financing is a commonly accepted form of finance and has been used in Virginia, the District of Columbia, as well as in Maryland. The National Harbor development was financed in part with a large TIF bond issuance.
- Because construction of a Metrorail station benefits the Land Bay G and H properties, as well as the PYRC, a special tax district could be created. With such a district (which was contemplated when the Potomac Yard CDD was created), additional tax revenues could be raised.

- If a 20-cent special tax district add-on real estate tax rate was levied on Land Bays G and H, as well as the PYRC, it could raise \$5.3 million per year at full build out which could be pledged towards the \$9.1 million in debt service. This would significantly reduce the amount of future tax revenues which might need to be used under the TIF financing structure described above.
- In conclusion, sufficient new tax revenues to finance a Metrorail station will be generated at full build out by the development of Land Bays G and H, as well as the PYRC. However, those revenues will grow incrementally over a decade or more until they reach their peak. The challenge for the City if it decides to proceed with building a new Metrorail station in Potomac Yard will be to develop a plan of finance which provides borrowing for upfront construction funding for the Metrorail station and then structures an amortization plan to repay that borrowing. Any plan of finance will also need to be consistent with the City's overall debt management practices and long range capital financing goals.
- Also, since some significant portion of the Land Bays G and H and a redeveloped PYRC will occur even if a Metrorail station is not constructed, the City will need to determine if the investment of new taxes generated by the development in the PYRC and Land Bays G and H provides a sufficient return on investment in overall community long-term transportation benefits to be warranted.

BOND SUMMARY STATISTICS

City of Alexandria Metrorail System

Dated Date	6/1/2008
Delivery Date	6/1/2008
Last Maturity	6/1/2038

Arbitrage Yield	4.389327%
True Interest Cost (TIC)	4.389327%
Net Interest Cost (NIC)	4.434542%
All-In TIC	4.389327%
Average Coupon	4.434542%

Average Life (years)	18.444
Duration of Issue (years)	12.189

Par Amount	150,000,000.00
Bond Proceeds	150,000,000.00
Total Interest	122,687,358.00
Net Interest	122,687,358.00
Total Debt Service	272,687,358.00
Maximum Annual Debt Service	9,092,193.50
Average Annual Debt Service	9,089,578.60

Underwriter's Fees (per \$1000)

Average Takedown

Other Fee

Total Underwriter's Discount

Bid Price	100.000000
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Bond Component	Par Value	Price	Average Coupon	Average Life
Serial Bonds	150,000,000.00	100.000	4.435%	18.444
	150,000,000.00			18.444

	TIC	All-In TIC	Arbitrage Yield
Par Value	150,000,000.00	150,000,000.00	150,000,000.00
+ Accrued Interest			
+ Premium (Discount)			
- Underwriter's Discount			
- Cost of Issuance Expense			
- Other Amounts			
Target Value	150,000,000.00	150,000,000.00	150,000,000.00
Target Date	6/1/2008	6/1/2008	6/1/2008
Yield	4.389327%	4.389327%	4.389327%

Estimate of Full Build Out Value of Potential Potomac Yard Development
(Chart reflects Land Bays G, H, Part I, and the Potomac Yard Retail Center only)

	<u>Office</u>	<u>Retail</u>	<u>Dwelling Units</u>	<u>Hotel Rooms</u>
Land Bay G (existing)	800,000	80,000 ¹	478	625
Land Bay H, Part I (existing)	60,000	5,000	400	---
Land Bay H (proposed) ²	765,000	---	---	---
Potomac Yard Retail Center (existing)	---	600,000	---	---
Potomac Yard Retail Center (hypothetical new) ³	1,000,000	150,000	2,500	TBD
Total	<u>2,625,000</u>	<u>835,000</u>	<u>3,378</u>	<u>625</u>
Unit Values⁴	<u>x \$400/sq ft</u>	<u>x \$300/sq ft</u>	<u>x \$350,000/unit</u>	<u>x \$250,000/room</u>
Total Estimated Value	\$1,050.0 million	\$250.5 million	\$1,182.3 million	\$156.3 million

ESTIMATED VALUE AT FULL BUILD OUT: \$2,639,100,000
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¹Does not reflect requested future potential conversion of 80,000 square feet of office to retail.

²Proposed office density transfer from Land Bays J and L.

³Hypothetical development scenario using Land Bay G level of density.

⁴Represent average values in 2008 dollars.